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**H.R. 2203 AND H.R. 2204, EXPORT-IMPORT BANK,
TIED AID WAR CHEST REAUTHORIZATION AND
DEFENSE PRODUCTION ACT REAUTHORIZATION**

DEPOSITORY

HEARING

JUN 13 1996

BEFORE THE

Stanford University
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SUBCOMMITTEE ON

DOMESTIC AND INTERNATIONAL MONETARY POLICY

OF THE

COMMITTEE ON BANKING AND

FINANCIAL SERVICES

PL 1030

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

SEPTEMBER 7, 1995

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**H.R. 2203 AND H.R. 2204, EXPORT-IMPORT
BANK, TIED AID WAR CHEST
REAUTHORIZATION AND DEFENSE
PRODUCTION ACT REAUTHORIZATION**

THURSDAY, SEPTEMBER 7, 1995

**HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL
MONETARY POLICY,
COMMITTEE ON BANKING AND FINANCIAL SERVICES,
Washington, DC.**

The subcommittee met, pursuant to notice, at 10:08 a.m., in room 2128, Rayburn House Office Building, Hon. Michael N. Castle [chairman of the subcommittee] presiding.

Present: Chairman Castle, Representatives Lucas, Metcalf, Barr, Chrysler, LoBiondo, Watts, Kelly, Ney, Flake, Frank, Kennedy, Roybal-Allard, Barrett, Watt.

Staff present: Cecelia Jardon.

Chairman CASTLE. The subcommittee on Domestic and International Monetary Policy will come to order.

Today the subcommittee is going to attempt a double hearing and mark-up off the high board with a degree of difficulty of 6.5. I didn't write this, by the way. We will be hearing from two distinguished witnesses, Mr. Kenneth Brody, President and Chairman of the Export-Import Bank, speaking on behalf of reauthorizing the Tied Aid War Chest; and Joshua Gotbaum, Assistant Secretary of Defense for Economic Security, speaking in favor of reauthorizing the Defense Production Act.

We will have 5-minute openings by the Members present who wish to get on the record. And, as always, for the benefit of the staff, any prepared remarks presented will be accepted for the record.

Following the testimony of the two witnesses and the respective questions addressed to each by Members present, we will briefly adjourn if a forum is not present, and then move directly to the respective mark-up of H.R. 2203 and H.R. 2204. Both of these bills have been introduced by request of the Administration, and both extend proven programs that would otherwise lapse.

[The prepared statement of Hon. Michael Castle can be found on page 28 of the appendix.]

I think for the benefit of those here, we will hear from Mr. Brody, who advises Mr. Flake and me that he has a short statement. And we may have to, at that point, break for a period of time

before Mr. Gotbaum can arrive, because I don't think he can get here much before 11:00 o'clock.

And we may have a vote, and God only knows what's going to happen out there. So I think, the sooner we get to it the better. And with that, let me turn to Mr. Flake to see if he wishes to make an opening statement.

Mr. FLAKE. Thank you very much. Mr. Chairman, may I begin by asking unanimous consent to have the statement of Ms. Maloney who is in China, entered into the record?

Chairman CASTLE. So ordered.

[The prepared statement of Hon. Carolyn B. Maloney can be found on page 29 of the appendix.]

Mr. FLAKE. Thank you, sir. Thank you also for holding this hearing and the mark-up on the bipartisan proposals to reauthorize the Tied Aid Authority of the Export-Import Bank and the legislation to reauthorize the Defense Production Act.

You just called it the War Act. I hadn't heard that before. But that's—

Chairman CASTLE. Tied Aid War Chest.

Mr. FLAKE. Tied Aid War Chest, OK. In the past I have supported these measures and I will do so again today. Given the gravity of the current debate on the size and purpose of various government agencies, I welcome the opportunity to learn from the two witnesses who come before us this morning.

Moreover, I wish personally to welcome our distinguished guest, Eximbank President and Chairman Kenneth Brody, and Assistant Secretary Joshua Gotbaum.

My fellow colleagues, I have been amazed at the intensity of the debate of whether or not we should fund the Eximbank. Both those who are in favor of the bank and those who vehemently oppose it have executed an overwhelming comprehensive lobbying campaign.

The result is that we have a broad spectrum of opinions as to how much closing the bank will save the American taxpayer. And it is no surprise several Members of Congress will base their votes on this aspect alone.

I must note for the record, however, that savings is not the only issue and to make it the only issue is short sighted. Most of our competitors in the industrialized world use economic credit agencies to assist their exporters. And thus foreign governments seek to ensure the viability of their industries in an ever increasing atmosphere of competitiveness.

Beyond this one aspect there are many salient issues. And probably more important to our constituents is the fact that exporting to the emerging markets is probably the only area where American business can expect to grow in the future.

To the extent that tied aid is just one tool that the Export-Import Bank uses to further this projected growth, I certainly urge my colleagues to support H.R. 2203. We would be remiss and should be embarrassed if we were to take several steps backwards and thus cripple American export business.

With respect to the Defense Production Act, I believe that no Member of Congress should have serious reservations about supporting legislation that ensures the security of our Nation. Since 1950 this act has guaranteed the Defense Department and the

American public that critical products would be available in times of national emergency.

Our recent success in the Persian Gulf War is testimony to the importance of this act. And possible military needs in this unpredictable post-cold war period dictate that future presidents be given flexibility to define and immediately satisfy critical military needs.

In closing, Mr. Chairman, I thank you and your staff for your cooperation. I regret that Congress as a whole does not have the relationship that we have established on this subcommittee, in terms of our accommodating one another. The public would be better served if we could extend the kind of cooperation that we shared here, that the whole Congress could do the best possible job for the American people.

Thank you very much. I yield back the balance of my time.

Chairman CASTLE. Well, thank you, Mr. Flake. And I think maybe, as you called it to my attention, we should not call this Tied Aid War Chest and put it together with the Defense Production Act. It could confuse everybody and create some sort of a problem out there.

Mr. Brody, it's been a pleasure getting to know you better and working with you. And you have a tremendous knowledge of the Eximbank and a lot of the other aspects of trade and finances which are of vital importance to this country. And we look forward to hearing from you now.

STATEMENT OF KENNETH D. BRODY, PRESIDENT AND CHAIRMAN, EXPORT-IMPORT BANK OF THE UNITED STATES

Mr. BRODY. Mr. Chairman, thank you for the opportunity to testify this morning. I have a written statement which I would like to not read but have entered into the record, if I could. And I have a few brief summary comments to make, and then I would be glad to answer any questions that you might have.

The legislation dealing with Export-Import Bank deals with two topics. One is the extension of our Tied Aid Credit Authority and, two is Demonstration Project Authority which gives us flexibility in personnel management.

Tied aid is basically long-term low interest rate loans given by donor countries to recipient developing countries in return for which the recipient country buys the goods from a company of the donor country.

What we do with respect to tied aid credit now is different than what was done in the past. In September 1993, President Clinton, along with announcing our new National Export Strategy, initiated an aggressive tied aid credit strategy.

Our objective with tied aid credits is to convince our foreign competitors to not give tied aid credits in the areas where American companies are competing for business or would like to compete for business. We aggressively match tied aid credit offers to give American companies a level playing field.

We are seeing results already, with this policy. We have been able to discourage the use of tied aid credits in certain competitive situations, we have discouraged our competitors from providing tied aid credits, and we have precluded our foreign competitors

from concluding deals. In so doing, we have kept our U.S. exporters competitive and not disadvantaged them.

Since January 1994, which is basically when we started this new policy, in eight cases we have gone to our competitors and said, you don't really want to do tied aid credits, do you? And they said, fine, you're right, we don't and we'll save our money for other projects. And our companies were able to compete based on their product capability, quality, and price. All the things that are normal criteria in competition.

In 33 cases, we have matched outstanding or prospective foreign tied aid credit offers of one sort or another totaling \$2 billion. These cases typically required an ongoing long time to process. Out of these cases, we have three wins for the American companies. Interestingly, two of them did not require tied aid credits in the final analysis, because the foreign governments backed away from it. To date, we have one actual funding. So there is a lot of activity, and we are seeing real results.

And right along with our earlier predictions, I think we will get further results in the future. Therefore, an extension of EximBank's tied aid and credit authority is needed to continue providing American companies with a level playing field, and to help foreign competitors decide to stay away from the American competitive field when giving their tied aid credits.

On the issue of personnel management, we are asking for the flexibility to do a 5-year demonstration project. This is really an evolution of the changes that we have been making at Export-Import Bank. And we are about at the end of our rope with the kind of Rube Goldberging or patchwork quilt approach of gathering the Civil Service Rules to have a sensible merit-oriented compensation system and personnel management system.

The demonstration project will be private sector oriented using best practices. It will be budget neutral. It will not cost any more money, but it will give us a lot more flexibility in proper personnel management, and it will continue employee safeguards.

This will give us a flexibility that will enable us to continue the kinds of improvements that we have been making at Eximbank. Thank you very much. I would be glad to answer any questions.

[The prepared statement of Hon. Kenneth D. Brody can be found on page 30 of the appendix.]

Chairman CASTLE. Thank you very much, Mr. Brody. One thing I note in some notes that were handed to me, and I didn't realize this before, apparently the rest of Eximbank's operations are authorized through 1997. And what we're doing today, obviously, is taking the Tied Aid Authorization in dollars only—well, it's only now until September 30, 1995. How did they get separated, do you know?

Mr. BRODY. Well, I wasn't here at the time. But, it is my understanding that there was a lot going on in the tied aid realm at the time of this legislation. The 1992 OECD Agreement had just been implemented which, in effect, reduced the amount of worldwide tied aid by close to half.

As a result, Congress wanted to see the results of our newly negotiated agreement. Therefore, they put a shorter date on tied aid credit reauthorization.

Chairman CASTLE. I assume without asking, and maybe I should ask, that you are in total support of the legislation which we're going to mark up here in an hour or so—

Mr. BRODY. Absolutely.

Chairman CASTLE. And the genesis of which is from your office, I suppose?

Mr. BRODY. It is directly in line with our new export strategy of being aggressive for American companies and creating a level playing field. And also in line with one of Eximbank's primary objectives of working to reduce worldwide subsidy in areas of governments assisting companies.

Chairman CASTLE. You and I have talked about this before, and I sense it again in what you are saying here today. I mean, to me the whole area of tied aid is a little bothersome. And it's been pursued by countries other than America.

My view is that we are doing this more defensively to make sure that you can't obtain their goods being sold to other countries to the exclusion of American goods, especially in areas in which we compete at higher levels. But ultimately, and I enjoyed the portion of your testimony that states that one of our policies is to try to make them recognize that so that they will not try to do that in dealing with some of these countries.

In fact, ultimately, it would be nice to say that tied aid could be eliminated, which maybe it can not be. But I'd just like to hear you expound and expand on that a little bit, because I worry about this. It doesn't have the ring of sort of the American capitalistic way of doing business somehow or another, but it appears to be necessary at the same time.

Mr. BRODY. Let me extend that even further. If there were no other export credit agencies, it would be my view that the United States should not have an Eximbank. The main reason we are there is to create a level playing field.

And what we are working hard to do is to reduce the amount of government assistance the others give their companies so we can continue to reduce ours. We don't try to give our companies an advantage, we try to create a level playing field.

This applies to tied aid as well. We would like for there to be no tied aid. But, as a practical matter, that does not seem to be realistic. What we can do, however, by this matching policy, is to make it very difficult for our competitor countries to gain benefits from giving tied aid credits in areas where American companies are competing.

After a while, it is likely that more and more tied aid credit will go to countries and projects where there is not American competition, which means that we won't have to spend any money on it. And we are seeing some of these results already.

Chairman CASTLE. Let me broach one final subject, and you and I have also talked about this, and it may apply more to the tied aid circumstances than even the rest of the Eximbank's functions. And that is the whole business of whether this is truly of commercial and economic benefit or it's corporate welfare, if you will.

A lot of people have alleged that the Eximbank basically has been most helpful to large businesses and smaller businesses have been left behind. And I know that you are trying to do a lot to off-

set both that image and to actually offset the facts of why it may have happened in the past.

But, is that also true as far as this whole tied aid business is concerned? And is that being taken into consideration?

Mr. BRODY. I'm delighted you asked that question.

Chairman CASTLE. It's not a setup.

Mr. BRODY. Let me just set out a few facts. As you so carefully said, a number of people have alleged and there is an enormous amount of misinformation being bandied about, which is understandable.

We are a small agency. We only have 450 people. And I think a lot of people do not really have the time to come in to really learn and understand us. Instead, they settle for broad sweeping generalizations that in many cases turn out not to be true.

First, over the past 3 years, 65-75 percent of all of the transactions that we have done have been for small business.

Second, of course, since small business deals are in smaller numbers, smaller overall volume than big business, the dollar volume isn't of that magnitude, but it is substantial.

Over the past 3 years, the amount of dollars financed for small business, of our total, is in the range of 15-20 percent of our total transactions. So, one, we see a very substantial and increasing effort for small business.

The number of transactions that we have done for small business over the past 3 years, using an estimate for fiscal 1995, shows that we will have an increase of approximately 50 percent in the number of transactions with small business. So we're out there working and we're starting to see some real results.

Interestingly, and a little bit surprising to me, we see that of the 33 cases in which we offered tied aid credit matching, 20 of those cases went to small business. I would have guessed that a much larger portion would have been for big business. And that's actually very interesting, and it's in line with the total activity that we're seeing at Export-Import Bank.

Now, with respect to the question of the need for our agency, and whether we're just giving something away, and the importance of it particularly today. I think there is no question that if Export-Import Bank did not exist to counter the export-supporting practices of our foreign competitors, Germany, Japan, France, the United Kingdom, and all the others, what we would see is a substantial loss of market share in those very markets, the emerging markets, the developing countries that are exploding today.

These are markets where literally billions of people are joining the free market for the first time and initial market shares are being made which will be built on for the future. I contend that the activity that we do in these important developing markets to create American jobs is an activity that is necessary, in fact, for the economic vitality, the future economic vitality, and our living standards going forward.

Chairman CASTLE. Thank you very much, Mr. Brody. Mr. Flake.

Mr. FLAKE. Thank you very much, Mr. Chairman, there has been a great deal of talk about whether the agency actually is duplicitous as it relates to what happens with other agencies, the Commerce Department, the Small Business Administration.

Even some have talked about putting your agency under the Office of Trade Representative. I'd like to know from you, for the record, what is your general feeling as it relates to what happens if you are merged into another agency?

How does it impact your effectiveness and what you do to, in essence, add another level of bureaucracy, and it seems to me, take away some of your independence? Can I kind of get a general view of your feelings of what happens if that process moves in the direction that some are suggesting it go?

Mr. BRODY. One, I think, consolidating Export-Import Bank into any larger apparatus is basically a bad idea. Let me tell a short story. Yesterday, I was asked this very question at an audience of 400 exporters

I turned the question around and asked these 400 exporters how many of them worked for big businesses. About 100-150 of them worked for big businesses, that raised their hands. I said, in your businesses, how many of you have seen a small highly specialized effective division combined with another?

Only two or three did. I asked the two or three, whose company had done that, whether their stock prices were up or down. They all said they were down.

So it's clear, one, that prevailing best practice is to have highly specialized small performing organizations work by themselves. That's how you get most effectiveness.

Second, in the government we have a serious question of independence and fiscal integrity. Export-Import Bank today is independent. It has an independent board of directors. It is not an arm of the U.S. foreign policy. It creates a level playing field for U.S. exporters, and at the same time makes sure that U.S. taxpayers are getting a good deal.

So we have many examples in the past year—and I'd rather not expose them to the public record, but I would be glad to talk with you about them—where we did not extend credit because it was the fiscally correct thing to do.

If this agency were part of another, almost surely the decisions would become political, the place would lose its independence, and fiscal integrity would just be done away with.

Mr. FLAKE. And would it also take away some of the flexibility in terms of your ability to respond quickly to changes that are taking place in the market for which you now can act and therefore put America in a better position from a competitive position?

Mr. BRODY. Absolutely. And one of the ways that that happens is not just because of the smallness, but because Export-Import Bank is a small, highly specialized, highly effective independent agency. It attracts a pretty darn good caliber of people, both Civil Service and political appointees.

My guess is that the ability to attract and retain that caliber would be really diminished if it were part of a larger organization.

Mr. FLAKE. Others would argue that consolidation would mean that you would in fact save money or that the government would in fact save money. Our analysis seems to suggest that no money would really be saved of any significant amount, and therefore it makes sense to maintain the agency as it is.

Can you give me your sense of what happens, as it relates to maintaining the agency independently versus merging the agency, as it relates to whether or not we save money one way or the other?

Mr. BRODY. I can't imagine that money would be saved. And I have never seen any study, even back of the envelope writings, that would credibly suggest that money would be saved.

Mr. FLAKE. All right. Lastly, can you give an explanation of Export-Import Bank's proposed demonstration project and human resource management? You've requested about \$47 million. I think the House appropriation is about \$45.2 million.

And the question is really, will the lack of getting the amount of monies that you have requested diminish your ability to do what you have set out to do? And how does it impact on your demonstration project?

Mr. BRODY. The demonstration project is revenue neutral. So the \$47 million is not related to the fact that we have a demonstration project. Having said that, we wouldn't have requested the \$47 million unless we needed it for maximum performance.

Obviously, if we end up with less, we won't be able to perform as well. We have the minimum we needed, and that's our best assessment, independent of the demonstration project.

Mr. FLAKE. Thank you very much. I yield back, Mr. Chairman.

Mr. LUCAS [Presiding]. Thank you, Mr. Flake. And I think I will pass on my question time. Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. I apologize for having missed your presentation. Unfortunately, I was in another markup and couldn't get here.

Part of the materials which I've been given in preparation for this hearing is a listing of the companies in my congressional district which have some involvement, I assume, with the Export-Import Bank. First of all, are you familiar with what I am making reference to?

Mr. BRODY. [Nodding affirmatively.]

Mr. WATT. Can you tell me a little bit more about what this document is? And, also, can you tell me how these businesses interact with the Export-Import Bank and how that works?

Mr. BRODY. OK. I am not sure of the exact document you have, but what we typically give you is a document containing Eximbank disbursement information for your State and congressional district.

What we have the ability to do, which we do on an ongoing basis and not just for this hearing, is to notify each Congressman every time Eximbank financing is done in your district. Part of the reason for doing that is we try as much as we can to get as big an outreach as we can.

We figure that the more people know about it, the more likely it is that others will know about it. A major part of the game in trying to do more for small- and medium-sized businesses is having them be aware of what is available. So every channel of marketing that is possibly available, we try to take advantage of.

Mr. WATT. I think I understand the reason you do it. I'm just trying to make sure what it is and—

Mr. BRODY. Let me tell you what you have and what it is. What you have listed here are a number of different companies in your

district who have done business from fiscal 1993 to date, with Export-Import Bank, and they've done business in three different ways.

We have either lent money to the buyer of their product, we have guaranteed a commercial bank to lend money to a buyer of their product, or we have insured the receivable that they have on their books from the sale of their product to a foreign buyer.

And what the list that you have is what the name of the company is; and whether they are a small business or not a small business, by the Small Business definitions; and what the export value is of the deal that we financed. In general, we finance 85 percent of the American cost of the deal.

Mr. WATT. Now, as it relates to this particular bill, H.R. 2203, and extending authorization of the Export-Import Bank's Tied Aid Program, would there be a connection or a triggering of that \$44 million, which is listed on that list that you had provided to me, to the tied aid aspect of this? Or might that be independent of tied aid—

Mr. BRODY. This is independent of tied aid credit.

Mr. WATT. OK. So this is not really related to the tied aid issue, this is what the Export-Import Bank does as a general proposition—

Mr. BRODY. That's correct.

Mr. WATT. Separate and apart from tied aid?

Mr. BRODY. Yes.

Mr. WATT. OK. So it would not necessarily take some other country engaging in some tied aid credit which we didn't like to trigger this guarantee or insurance that you've listed on the list you have there?

Mr. BRODY. Well, let me say yes and no. Let me explain that. With tied aid it's absolutely formal. Another country has to initiate and we match when the circumstances are correct for doing that. That is a very different part of the total activity of our business and of what we do. Tied aid credit is a very small part of it.

What we do as a matter of course at Export-Import Bank is to make a subjective judgment on each and every deal that we finance that the deal would not go forward were it not for Eximbank financing. Most of the time that means that there would be a foreign competitor who would be getting financing from its export credit agency.

So it's not as formal, and it's not all the time, but there is a link in philosophy. We're here to create a level playing field, but we're only used where we're needed.

Mr. WATT. So if you'll indulge me one question, just a clarifying question. What I understand you to be saying is, you have made a determination at the Export-Import Bank, with respect to that \$44 million which you've listed on the sheet you give me, that but for the involvement of the Export-Import Bank in that transaction this export would not take place, this business transaction would not take place; and that is the triggering mechanism for the Export-Import Bank to get involved? Is that—

Mr. BRODY. That's correct.

Mr. WATT. OK. Thank you, Mr. Chairman.

Mr. LUCAS. Thank you, Mr. Watt. Mr. Metcalf, do you have any questions?

Mr. METCALF. Yes, a couple. Which of the donor country's governments are the most frequent practitioners of this tied aid concept?

Mr. BRODY. France and Germany.

Mr. METCALF. OK. I didn't expect that. Thank you. Have the bank's activities thus far curbed the use from these countries or other countries of this practice?

Mr. BRODY. What I would say, and this is subjective judgment based on actual cases that we see before us, I don't think that we have curbed the overall tied aid credit activity of the foreign competitor governments

On the other hand, I do think we have curbed it where we care, and that is when there is likely competition from a U.S. company.

So, I think what the effect of our actions is, is to cause tied aid credit givers to think twice when a U.S. company is in a deal, to think: We're going to have to deal with the U.S. Export-Import Bank and their aggressive matching policy, so why don't we make life easier for ourselves, and not tangle with the United States.

There's lots of other ways to give tied aid credits to reward our companies, and to give tied aid credit to the recipient countries without having the difficulty of running into this matching policy of the United States. We can find other projects or countries to give tied aid credit to. I think that, in fact, we have already started to see this.

Mr. METCALF. OK. As I understand this Helsinki package, and I'm no expert on this at all, but their effort was to induce these kinds of distortions. Has that been at all successful?

Mr. BRODY. That was a good step. And I can summarize I think in rather simple straightforward terms, because I'm no expert on it either. Essentially, what the Helsinki Accord (or the Arrangement) did was make it more expensive for countries to give tied aid credit, so that they couldn't easily give tied aid credit to have their companies win. They had to spend real money to do it.

This arrangement resulted in a whole set of rules in areas that you cannot give tied aid credit. For example, you cannot give tied aid credit for projects generating substantial commercial revenues. As a result, the amount of tied aid credit has been halved roughly from the mid-teens to \$7-\$8 billion a year.

Mr. METCALF. OK. Is this practice something that sort of establishes a commitment that can potentially lead to significant financing commitment in future years? Isn't this something that we're sort of getting into and it might become more habit forming?

Mr. BRODY. There is definitely the risk that our matching policy can end up with a greater financial commitment in the future. Because these deals take a long time, we have put out preliminary matching offers in 33 cases of close to \$2 billion.

We have basically made a judgment that the likelihood of a lot of that business coming home to be finalized into real tied aid credit is very low. And I think the results that we have to date demonstrate pretty convincingly that that judgment is probably a pretty good one.

Let me elaborate on this issue a little more. In addition to the 33 cases, we got the other foreign competitor governments to back off from using tied aid credits in 8 other cases. In these instances, we obtained an agreement not to do tied aid credit.

When an exporter comes in to us and says, some other government is going to do a tied aid credit, and I'm going to lose the order, we then go around and say, let's not do that. In eight of these cases we got them to back off. Of the 33 matches that we have, we have three American company wins of orders, only one of which ended up using Eximbank's Tied Aid Credit Fund. In the other two cases, standard financing was used.

So far, there are five foreign competitor wins. Only two of those were with tied aid credits. In three cases they ended up in non-tied aid competition. Since every tied aid case involves competition head-to-head, we will not win all of them. I think what we are seeing is the odds of this whole amount coming home, or even a large amount of it, is very low.

Mr. METCALF. One last brief question. What is the carry-over authority that we have for this? Is there any money there in the bank or in the till for use? How much can be carried over?

Mr. BRODY. At the end of fiscal 1995, which will be this September, it's our best estimate that we will have a little more than \$260 million Tied Aid Credit Authority carried over. Obviously, if this bill were not approved, we would be dead in the water with that.

This \$260 million in tied aid credit authority would translate into the financing of between \$600-\$900 million of U.S. export sales.

Mr. METCALF. Thank you, Mr. Chairman.

Mr. LUCAS. Thank you, Mr. Metcalf. Are there any other Members who would care to offer a question?

[No response.]

I guess seeing none, any final comments you'd like to make, Mr. Brody?

Mr. BRODY. I just thank you all very much for your time. I know that this is particularly busy time for you all, and we appreciate the opportunity to testify on this bill.

Mr. METCALF. Mr. Chairman, are we short of time?

Mr. LUCAS. No, not if you have additional questions.

Mr. METCALF. I didn't really understand the answer to the last question, the carry over authority. What is the total appropriation we are talking about here?

Mr. BRODY. The carry-over appropriation is because we have singled out appropriations done in the past, including fiscal 1995, for tied aid credits. We have actually used very little of it.

The reason that we have used very little of it is we are achieving big success in matching, and in others having our foreign competitors withdraw their offers of tied aid credit even though we have offered it. We offer it, we don't use it. We only use it when an actual deal happens, when an actual foreign tied aid credit offer is made, when an actual sale takes place and we have financed it with matching tied aid credit.

So, therefore, the way our legislation works, we are able to continue carrying over a tied aid credit budget from year to year. If we don't use it, it accumulates and builds up. The budget is not the

amount that we finance. The budget is the expected loss on transaction, and the expected present value of the loss on the transactions.

When I said we have about \$260 million budget at the end of this year for tied aid credits going forward, the reason that translates into \$600-\$900 million of actual financings of tied aid credit exports, is because that would be the budget component, or the subsidy component, that we would be putting into those tied aid credit deals that we're actually trying to keep very low by this matching policy.

Mr. METCALF. OK. What is the amount that we're appropriating under this bill or authorizing—

Mr. BRODY. We're not appropriating anything. We're not authorizing anything, any amount. All we're doing is extending the period of authorization.

Mr. METCALF. OK.

Mr. BRODY. When this Tied Aid Credit Authority was given, it was given for a period 2 years shorter than the authority for Eximbank itself. The reason for that is Congress wanted to have a look-see because of the Helsinki Accord and all sorts of things going on with tied aid usage, so there would be this opportunity to take a look at it. And that's what we're really doing here.

Mr. METCALF. Thank you.

Mr. LUCAS. Thank you, again, Jack. And once again, thank you, Mr. Brody. It's my understanding that we're approximately 10 or 15 minutes away, due to the expeditious nature of the subcommittee hearing this morning, from hearing our next witness. So I think the thing to do would be just to suspend this subcommittee hearing until the call of the Chair.

Mr. BRODY. Thank you very much.

[Recess.]

Chairman CASTLE [Presiding]. The subcommittee will come to order. We are at the second stage of our hearing which is on the Defense Production Act. And we are very privileged to have Mr. Joshua Gotbaum, who is the Assistant Secretary of Defense for Economic Security.

I've already advised him that we are dealing with a subject matter, which is probably not number one in terms of the knowledge of the Members of Congress of the United States, the Defense Production Act. So we're interested in his testimony as perhaps an educational experience as much as anything else.

So, Mr. Gotbaum, if you will make whatever statement that you wish to make, sir. And after that time the various Members may have some questions to ask of you.

STATEMENT OF JOSHUA GOTBAUM, ASSISTANT SECRETARY OF DEFENSE FOR ECONOMIC SECURITY

Mr. GOTBAUM. Mr. Chairman and Members of the subcommittee, thank you very much for hearing us this morning. With your permission, Mr. Chairman, we've submitted a written statement which is, in the usual fashion, relatively long and wordy; therefore, I would propose not to read it but to summarize our views and hit the high points, and then open it up for questions.

The Defense Production Act is like the Ripkin family. It's been around a long time, it's relatively quiet. It is, in our view, a useful tool, something that helps us do the business of the Nation's security. We've found it useful time after time, case after case, for a very long period of time.

We continue to use it today in different forms. So it is for this reason that the Administration supports H.R. 2204, which would extend the act more or less in its present form for another 3 years, until September 1998.

I'm going to talk a little bit about what each provision of the act does. But if I may step back for a second, this is a case, in my opinion, Mr. Chairman, of "if it ain't broke, don't fix it."

The Defense Production Act was written 40-plus years ago. It has been modified a number of times. It was modified substantially in the mid-1980's. It was modified in 1992, and so forth. And it is written extremely broadly, written relatively flexibly, fortunately, I will say.

Therefore, I think, the first point I want to make is, it is useful. As we use it, we have modified what we do with it over time. I'll talk about that in that context.

But my real message is, if you read the act you will see lots of things there that are broad, and you will ask why did they do that, and so forth.

I think the critical message, and my most important message, is that the way we use this act, we think, is entirely sensible and is entirely dedicated to maintaining the business of the Nation's defense.

So the reason we ask for you to roll this bill over substantially in its present form is not because we couldn't tell you that we couldn't redesign many of the sections in it, but because we think the way we use it now is effective and helpful.

Let me, if I may now, talk about the three main titles of the act, what they do, and then open it up to any questions that you may have.

Title I of the act is entitled, "Priorities and Allocations." And this is the provision that gives the executive branch, the President of the United States, the authority theoretically to direct production.

What we use this authority for today, however, is to designate those contracts that are clearly of priority to the Nation's defense, and I will say since the Congress amended the law the last time, or to another form of national emergency, such as a disaster, and so forth.

Then for those priority contracts, we are able to, in some circumstances, direct people to move them to the front of the line. And that's really how we use this.

For example, very recently, in Bosnia we had a need for radios, portable survival radios, for our Allied Forces. They were things that are in production. The issue was how quickly would they be produced, and when would our allies' orders be shipped in comparison with other peoples' orders.

And we said, "We need this one, fast." You might say, "OK, why do you need the Defense Production Act to do this? Can't you just go to the manufacturer and say, this is the Nation's defense?" The fact is, we can do that and we do do that.

The advantage the Defense Production Act gives us is when we do so, it enables the manufacturer to know that if he complies, that other suppliers will not be able to drag them into court and say, you broke my contract because you were trying to help the Nation's defense. So, that's the reason why we find Title I very useful.

The way we use it, quite frankly, is not to create products that don't exist, not to commandeer whole factories, but to move things to the front of the line. We used that kind of authority to get Global Positioning System [GPS] radios during Desert Storm, to get charcoal for gas masks. That's the sorts of things that we use it for.

I cannot tell you that every single instance has been immediately needed items in wartime. But the vast majority of them have been, and the vast majority of them have been of the kind that we talk about. So that's Title I.

Next, I'd like to talk about how Title I operates.

It has an internal system of checks and balances because although the Department of Defense is the organization that says we need this, the Department of Commerce actually issues the orders.

The theory there, as I understand it, was to make sure that Defense does not demand too much, does not get too aggressive. And, therefore, we're going to have another cabinet agency, one that is sensitive to business and commercial concerns to actually implement the orders.

That is how we work this process. So that's Title I, Priorities and Allocations. We have found it useful, and we continue to find it useful today.

Title III is a different kind of authority. Title III's official title is Expansion of Productive Capacity and Supply. It gives the Federal Government the ability to provide a range of production incentives to make sure that we have industrial capacities that we think are essential.

I want to start by talking about the range of those authorities because there are other programs that try to achieve the results of Title III in the Defense budget and elsewhere. But what Title III does is it gives us a range of ways to get there.

Title III says if you have something you need, whether it be an advanced material, or a particular kind of equipment, a process, or whatever, you can use money that's been authorized and appropriated to buy it.

Or you can say, I will guarantee to a manufacturer that someone will buy it, some part of the Department of Defense or someone in the commercial sector. In other words say, if you produce it, they will come; or if not, we will come.

The other parts of the authority are loans, loan guarantees, and so forth. So my first point is that Title III gives us flexibility, and that we have found useful. How have we used it?

First of all, these are all technologies that we need for defense, a range of technologies that are useful for defense to make sure that they are available.

Let me give you some for instances, if I may. Gallium arsenide is a compound which you can use to make semiconductors, the basis of computer chips. It has some properties which mean that it is especially useful for war fighting. It's faster and can be made

in ways that are tougher, and so forth. It's also, frankly, very expensive.

And so what we did, using the Title III authority that was given to us by the Congress in the mid-1980's, is to say to several potential manufacturers, "if you produce this stuff, we'll buy it. We'll guarantee you that we'll buy it."

Now, in fact the actual customers didn't necessarily have to be the buying office, which is overseen by my office in the Department of Defense and run by the Air Force. The actual customer might be the Advanced Research Projects Agency, or a particular manufacturer that is building a system.

We essentially put a floor, an insurance factor in there. As a result, I am pleased to say that today we have two or three manufacturers of gallium arsenide that are meeting Defense's requirements. Because they knew that we'd be there, they knew if they produced it, we'd back them up.

Other advanced technologies that we are working on right now include a very high purity silicon for semiconductors. Silicon sapphire has some characteristics (although it again is expensive) that make it less susceptible to radiation and electronic bursts, which means that we can use it in military systems.

We're working on other things under Title III, for example, composites. As I'm sure you all know, metal composites and non-metallic composites are enormously useful because they are very high performance. They are also expensive. So using the authorities in the Defense Production Act Title III we said if you build this, we'll buy it.

By putting a floor under the production of these kinds of materials, and by giving manufacturers some confidence, we hope to encourage them to build them, and assure them that people both in defense and in the commercial world will buy them. Because that's the way we really save money. In lots and lots of technologies now, the most active part of the market is in fact the commercial world.

Just to give you some for instances. The Department of Defense underwrote the research that built the computer chip and it built the computer. But nowadays we know who is buying most of them.

If we can take advantage of commercial opportunities, or if we can give defense manufacturers, on things that we need in defense—and I want to be real clear that we only use this for stuff that we need in defense—if we can give them some confidence that if they build it, we'll buy it. They can also, in these areas that are dual use, produce it for the commercial sector as well as the defense sector. That, frankly, gives us the kind of robust industrial base we need for the long haul.

For Title III, we had \$200 million appropriated in 1994, \$100 million of that has been rescinded. We have been using \$100 million on a variety of projects, some dealing with electronics, some dealing with advanced materials, as discussed earlier.

We also have projects on flat panel displays. You know, the things that you see in all these lap top computers? They are enormously useful, and they have some special Defense applications. Most of them are not produced in the United States. We set up a program again that said, if you'll produce, we'll guarantee that we'll buy them. We're hoping and we're expecting that in addition

to our buying some, the commercial sector will also buy some so that we'll actually have some robust capacity here in America.

But, again, the purpose is to make sure that we've got these for Defense. We're using Title III money, for example, to pay for the cost of putting these flat panel displays into programs like Apache Longbow, the F-16, Global Positioning (satellite) System [GPS]. So that's the way we use this kind of authority.

I would be the first to admit that this is not the only way to make sure that we have production capacity. We could, for example, just continue to buy a particular product as an alternative. But a lot of times, that's an expensive way to go about it.

We find that we can actually do better for the taxpayers and maintain the Nation's defense by issuing a guarantee rather than issuing a purchase order. So that's Title III, our supportive production capacity.

Title VII has a variety of miscellaneous authorities and I'm going to touch on two. One is generally known as the Exon-Florio amendment—that's the authority that says that the President of the United States can review acquisitions by people outside the United States from companies inside the United States.

And again, Mr. Chairman, I would characterize this as a case where you've got to look at what we actually do, rather than just reading the statute to see why it is in fact useful. The authority was written relatively broadly. The President can review anything.

The fact of the matter is that we get hundreds of applications for Exon-Florio a year. In a very few cases we say, let's look and make sure that we are not getting technology transfer that puts our own technology base at risk.

In the years that there have been this authority in Title VII, there's been only one acquisition that has been blocked. There have been some others that, I will be frank, have been discouraged. And there have been still others where we have suggested that the acquisition go through, but that there be safeguards on the national security. And that's how we use this authority that the Congress has provided us under Title VII, the Exon-Florio authority.

Also in Title VII there is authority to bring in private sector expertise on an expedited basis, to get executives to help the government, to assist the government, and so forth, to set up advisory committees, and so forth. So there are some other provisions in that title.

The ones that I've mentioned—Title I Priorities and Allocations; Title III, to Expand the Productive Capacity in the United States; and Title VII's, Exon-Florio provision—are those which we use most frequently.

We believe that this is the program which has been quietly very helpful to the Nation's defense. As you can see from my example about the radios, we're not saying that there aren't other ways to meet the goals of the Defense Production Act, but that they are more cumbersome, they are slower, and they are harder. And, therefore, we find the Defense Production Act as used, a very effective tool.

It is for that reason that we hope the subcommittee will support the bill and will extend and will continue the authorities which we've found so useful for the last, actually, 45 years. Thank you,

sir. And I'd be happy to answer any questions that you or the subcommittee may have.

[The prepared statement of Hon. Joshua Gotbaum can be found on page 44 of the appendix.]

Chairman CASTLE. Thank you, Mr. Gotbaum. My question is going to probably be limited to one, and may be rather general in nature. And, again, I'm trying to make sure I understand all this.

But a lot of what you say to me makes great sense in terms of national emergency, any kind of war matter that the United States might be involved in. As you get away from that, it would seem to me to be less compelling to have some of the authorities which you cite. And I'd like to be comforted to some degree with respect to that.

I don't like thinking that, gee, all of a sudden we've given what should be wartime powers to the Department of Defense which they are carrying out during peacetime and it's perfectly acceptable.

I guess the second part of the question really is, are you doing something which the Commerce Department or others should be doing, or are you imposing, for example, preferences of the military in terms of economic development in this country for a particular product, for example, that maybe you want to move to the fore, or something of that nature. These are the kinds of things that worry me.

I've not heard of any of this. As you've indicated, this is something that's worked pretty well; it's not, you know, if it ain't broke don't fix it strategy. But I do worry about that a little bit, in a very general sense. If you could address that?

Mr. GOTBAUM. Mr. Chairman, I think I probably shouldn't say this in a public record. Part of the reason my job was created in the Defense Department was really to help us rethink the way we do programs and restructure them since the world has changed. The Soviet Union is not what it was, and so forth.

So when you read through the Defense Production Act, it is theoretically enormously broad. It does say that nothing we can do under this act can be done without a finding that it is necessary to the Nation's security. In other words, the Under Secretary of Defense for Acquisition and Technology has to sign a finding to that effect. I think that's point one.

The law contains limitations that say this is only to be used to advance the Nation's security or, I will note that the Congress has said that we can use some of these authorities in Title I in times of national disaster or emergency, and so forth, but essentially times of high stress.

One is, that's in the law. Point two is, I think this is a case in which you really can look at the historical record, because it's a record that goes back beyond this Administration. It's not a record of a single Administration. It's not a record of a single party.

The fact of the matter is that the way we use these authorities, in my view, is sensible. And the fact that you have not heard complaints, to my mind, is the strongest endorsement of that. So it's very important to separate out the theoretical from what is actually done.

What we actually do in this, in my view, is quite sensible. The best comfort I can give you is that is the way it's been done for a considerable period of years.

The question of whether or not we are substituting military preferences over the preferences of the commercial economy, again, is a entirely legitimate theoretical concern. But I would say in practice, the way we've done it is pretty sensible.

We have not tried to divert whole production forces. I mean, you could create scare notions and say, oh my God, is the Defense Department going to use the Defense Production Act to divert the entire automobile industry to producing tanks next week? The answer to that is clearly, no. It's just not going to happen.

I could give you theoretical reasons. One is that the law says anything you do here has to be done really to advance the national security.

Number two, the implementation is done by the Secretary of Commerce, not by the Secretary of Defense. Three, quite frankly, we haven't done it. I think the best comfort is the fact that people have acted responsibly in this program for a long period of time, sir.

Chairman CASTLE. Thank you very much, Mr. Gotbaum. Mr. Flake.

Mr. FLAKE. Thank you very much. Mr. Chairman. One question just quickly. And that is, when you talk about an Administration or program that's been set up for so many years and it has had revisions, and, of course, I'm supporting making sure that this particular entity continues to exist.

I guess with all of the questions that have gone on around the Congress here, I'd just like for the record, for you to state, given the definition that you've just given of the responsibilities of Eximbank, what it has done, what it's prospective responsibilities are which do not change significantly—I'm sorry, the Defense Department. We got it. They got me on this war thing earlier.

Mr. GOTBAUM. Sorry. Ken Brody escaped you, sir.

Mr. FLAKE. The problem that I have is, as others have talked about, is various kinds of changes that I think very well may be deleterious to the Nation. Can you just give us your overview of what happens if you start talking about a member nation, a merger, or changes in the agency that could be very destructive as it relates to our posture as a Nation, where we sit?

And what you are able to do with the kind of independence, flexibility, the ability to make the proper adjustments at the proper times? Just give me your general overview, and that'll be my only question. So you can take as much time as you wish to respond.

Mr. GOTBAUM. I want to make sure I understand. Is the issue here our ability to implement the goals of the Defense production side if we didn't have this law?

Mr. FLAKE. That's correct.

Mr. GOTBAUM. OK, sir. I should say I came from outside the Department of Defense, sir. I was a partner at Lazard Freres, in New York, and I was brought in precisely because I wasn't from Defense. They wanted that commercial perspective.

I will tell you the thing that has impressed me most about this department. We do what is necessary to protect the Nation's de-

fense. And I believe in being very straight with people, so I'm not going to tell you that if this law lapsed that we wouldn't do what is necessary to make sure we have production capacity.

There are other authorities that we can use. One is the Selective Service Act, and so forth. But I will tell you, sir, that if it lapsed, for example, let's suppose you had a manufacturer who had a kind of radio that we really needed, radios like we used in Bosnia, or radios like we used in Desert Storm, and so forth. Nine times out of ten, if we called that guy up and said, hi, this is the Defense Department, we really need these radios for guys who are getting shot at, they will do it.

But I will tell you, sir, that without the Defense Production Act that guy's lawyer will say to him, psst, you've got a contract to deliver those to so-and-so next week, and he can sue you.

The Defense Production Act enables us to say, when you serve the Nation, you are not put at legal risk. That's really why we think this authority is useful. And that's why we hope you will confirm it.

We rely every day on the good will of American industry, and we get it, but this law permits them to help us without fear of legal retribution or anything like that, sir.

Mr. FLAKE. And you don't need to be put in a position where each time the adjustment needs to be made, you have to run back to the Congress, or you have to seek some kind of authority to do what is in the Nation's best interests, because then the politics of it comes into play and could make a big difference.

Mr. GOTBAUM. Obviously, congressional oversight is extremely critical and every time we do anything under Title III there is congressional notification. So you should understand that this is not something that we do in the dark at all.

But you are absolutely right that we are busy, you are busy. If we had to come back to you for legislation every time we needed one of these contracts, it wouldn't work very well. And that's the reason why we think having acquitted this authority responsibly, we hope you will continue this authority.

Mr. FLAKE. Thank you very much. I yield back, Mr. Chairman. I have no further questions.

Chairman CASTLE. Thank you very much, Mr. Flake. Mr. Metcalf.

Mr. METCALF. Thank you. This is very interesting testimony. And I am one who is concerned about the authority.

I am very reticent to have a lot of authority out there that as you say, we have the authority to do this, but look at how we use it. We use it responsibly and so forth. And that is something that I appreciate. And I understand the necessity to have the authority that you need. But I'm also really concerned about this.

And spring boarding off of the chairman's question, and I understand the need to be able to tell a supplier that you won't be liable to be sued, and that's fine.

But beyond that, I'd just like to know what authorities can you tell us about that you have that you are not using that we might be concerned about? Because you made several references to this, and it's very interesting.

Mr. GOTBAUM. Congressman, the reason I raise it is that the original Defense Production Act was written in 1950. It was used as a vehicle by first the Truman Administration and then the Eisenhower Administration to move industry in a very broad mobilization.

Because at the time the way we fought wars, long sustained efforts, you knew that this was not just a matter of, can I supply the troops for 6 months. You knew that you were going to need extensive mobilization and extensive expansion.

So the authorities were written broadly, and they really were used to provide the legal basis for building whole factories, for example.

Mr. METCALF. Sure.

Mr. GOTBAUM. OK.

Mr. METCALF. But that isn't needed now.

Mr. GOTBAUM. I would admit that in a second. But I would also tell you, (a) it's not needed and hasn't been used in 20- or 30-plus years.

Mr. METCALF. Yes.

Mr. GOTBAUM. But the other point that I would make is, it's not something that we would do or have done.

Mr. METCALF. Then why don't we take it out?

Mr. GOTBAUM. Because I think, Congressman, the sense that we got from this is because Congress is busy and has a lot of things on its plate. There was not the desire or the need to go through and really do a modernization and updating of the Defense Production Act. I should have stated that up front.

I would admit instantly that there are plenty of provisions in this act which if we went through and worked, and it would be a work of month not of days, and it would be work that would involve our agency, the Department of Commerce, the Federal Energy Management Agency, the National Security Council. So my point is it is a big effort to go through and figure out how to modify the law.

Our view was that that wasn't a particularly good use of the taxpayers' resources either, because most people thought the way we implement the law is sensible. I can't tell you that as a theoretical matter you couldn't make lots of changes and, in fact, some improvements in this law. I think you could.

But the sense that we have gotten from conversations with various members of the staff, and also frankly from within the Administration, is that this is something that in practice is not broken. Therefore, given the fact that we are busy and the taxpayers' give us limited resources, we would not propose to enter into that exercise.

I would tell you, of course, that if the Congress directed, if the Congress said we must change this law, we must modernize this law, obviously we would do it because there are authorities in this law which we absolutely need. OK, sir?

Mr. METCALF. OK. I guess I'm one that would sort of like to see us start and redo something that needs redoing. And that's the job of this subcommittee and that's our problem.

I appreciate very much your testimony and bringing it up. I do believe that perhaps this subcommittee should take a look at that for the long haul. We maybe can get by for now, but for the long

haul I really think that history has shown, and I'm a history teacher, history has shown that potential powers by governments tend eventually to be used not necessarily in the best interests of the public.

Mr. GOTBAUM. That wasn't a question, sir, but if the subcommittee would permit me to state two things.

Mr. METCALF. Absolutely. Go ahead.

Mr. GOTBAUM. One of the things about the Nation's defense is that an enormous amount has changed in the last 10 years, really enormous. The nature of the threat has changed, the nature of our organization, thanks to the Goldwater-Nichols Act.

The way we fight wars is different today. The way we train people, the way we equip people, and so forth. So I understand that there is always an inherent risk with a theoretical power, that it will be exercised.

But I must tell you, Congressman, I think the Defense Department has sufficient constraint in its own resources, and has sufficient demands in its mission, because our budget is down 40 percent.

Yet actually two things are true. One is, although we are not fighting a major war now, we are in fact deploying more people more often than we did in the 1980's.

As a result, the truth is we have more resources invested in training. Therefore, I think it is less likely rather than more likely that these sorts of things would be engaged in. We just don't have the budget for them.

I don't want to deny the lessons of history, but I think enough has changed within the Department of Defense so it is considerably less a risk than it was 20 or 30 years ago, sir.

Chairman CASTLE. Thank you, Mr. Metcalf. Mr. Barr.

Mr. BARR. I thank you, Mr. Chairman. Secretary, I don't know how many times you used the word "theoretically," but many times. We're not dealing with a theoretical law here, are we? We're dealing with a real law, with real powers that are in fact used. We're not talking about a theoretical issue here, are we?

Mr. GOTBAUM. Congressman, the law grants authority to the President of the United States.

Mr. BARR. Not theoretical authority, authority.

Mr. GOTBAUM. A grant of authority.

Mr. BARR. OK.

Mr. GOTBAUM. Those authorities which are used are the ones that—

Mr. BARR. That doesn't make the ones that aren't used theoretical.

Mr. GOTBAUM. No, sir.

Mr. BARR. OK. So I think you are trying to make something sound a little too benign here, sort of soft-soaping all of this. You all don't worry about this, it's been used benignly, it's all theoretical, don't worry about it, things have changed. And, yes, maybe we ought to go back and look at this, but that would take too much time and too much money.

I don't like that kind of attitude, and I don't mean that personally. I just don't think that's a great attitude. Yes, the world has changed considerably. And if that provides a sufficient reason to

take a look at some of these laws, then I think that any Administration ought to take a look at some of these laws.

And not come up here and say, you know this law is 40 years old and it provides vast authorities that, well, we may or may not use them. And probably it should be addressed and we should have something that's more in conformity with the year 2000 than the year 1950, but don't worry about that. You know, don't worry about it.

I do worry about it. As my colleague from the State of Washington has said, our constituents worry about it. I mean I understand what you are saying, I have a legal background.

And I understand contract law, and when you are talking about some of the provisions in this law that absolve a company from legal liability if the government exercises its real authority under this act, that that's important.

The law doesn't simply state that the President is authorized to absolve a company from legal responsibility, it authorizes the President to direct that a company do something, isn't that correct?

Mr. GOTBAUM. Yes, sir.

Mr. BARR. OK. And it, in fact, authorizes the President to direct that a private company do certain things, not simply because there is a war or has been a declaration of war. It could be the President decides something is wrong in Fredonia and he wants to send some troops over there.

And the American public may not even know where Fredonia is. And the public may not want us to be involved in Fredonia. But this authorizes the President, if he thinks or believes that it is in his vision of the national security, very broadly defined, that we need to be there.

And that a company which has a unique capability to provide or manufacture a certain product that is unique to the environment in which our men and women will find themselves in Fredonia, the President can go to that company and say, we found some assistant secretary or something—it's very easy to find anything we want in the national security—has found it in our national security interest to invade Fredonia, or do something in Fredonia, we need you to put this contract ahead of your others.

This law would authorize that. I mean, it's not limited, is it, in terms of a wartime situation, a declaration of war, or whatnot?

Mr. GOTBAUM. I think I need to say a couple of things. Number one, about the President's authority as Commander in Chief to engage in military action, that is something that's under the Constitution and the War Powers Act, and so forth.

This law simply says that if it is found necessary to the Nation's defense, that the government can put and basically direct that the production under contracts be undertaken. That's what the authority is in it's broadest form under Section 101, Title I.

So put aside the question of whether we should or should not be in Fredonia, or other places whose names are already in the newspaper, this law doesn't do anything about that.

What this law says is that if we are in Fredonia, or if it is necessary for the Nation's defense, or—because the Congress has modified this law—or if it necessary in order to bring relief, for example, to the folks in Southern California affected by the earth-

quake, then the President has the authority to say, you have got a contract, can you move it? The third point I want to make—

Mr. BARR. So this really does go beyond national security, in the traditional sense that we think of, to domestic activities as well?

Mr. GOTBAUM. Yes, Congressman, it does. But the third point which I think is important to make is that you raised the question about shouldn't we modernize this. And I will tell you, Congressman—

Mr. BARR. You raised it.

Mr. GOTBAUM. No. You're right. In practice, we are. And let me talk, if I may? I don't want to over stay the time, but I think it's important.

Let me talk about the Title III. That's the part where we try to show that we've got productive capacity by purchase guarantees or purchases, and so forth. Originally that authority was used essentially to make sure that you could have, for example, rubber for the war effort.

But what do we use it for now? What we use it for now is to say we've got technologies, things that are at the cutting edge, things that really would be useful to the national defense that might be also of commercial significance.

So we need them, and depending on how they are produced and how cheap they are, other people could use them as well. And those are circumstances, flat panel displays, gallium arsenide, high purity float zone silicon, there are others, that's how we use this law now. And so—

Mr. BARR. This isn't the only program or authority under which the government can provide incentives for private industry to develop cutting edge technology. You're not making that argument, are you?

Mr. GOTBAUM. Actually, Congressman, putting aside the question of cutting edge technology, this is a program which permits us to procure capabilities, production capabilities without just making grants. Because when a lot of people look at this program, they say, well, you guys spend a lot of money on production and R&D. And our answer is, we do.

But the only authority we've got to say to somebody, we'll put a floor under your production, even if we don't take it, is these authorities. The reason I raise it is because, yes, the words are in some respects 40 years old; but what we do with this is really very current in a lot of today's technology.

I don't want to give the subcommittee the misimpression that this is just a group of folks who were 20 years old in 1950 and now are 70-plus years old implementing the same old authorities. We are implementing these authorities, but we are doing them to get really very modern technology, and very modern capabilities, things that we need.

Mr. BARR. Thank you. And I appreciate the chairman's indulgence.

Chairman CASTLE. Thank you very much, Mr. Barr. Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. Let me not belabor the points that have been raised, and say at the outset that I will vote for this bill, the extension. But I think I am equally troubled by

some of the things that you are saying, as Mr. Barr and Mr. Metcalf are.

And I think the thing that I would seek is some reassurance that somebody is beginning to take a look at this law so that at some point in the foreseeable future a proposal will be made to this committee that restructures this law in a way that makes more sense in today's world.

I think I understand the practicalities of not doing that immediately. But it does seem to me that if we are engaged in a massive restructuring of government, that the military component of that, the defense component of that should not be exempt from that evaluation.

And there is a perception that the defense mechanism is being used to some extent as an employment program more than as a strategic and military defense program.

And to the extent that that is being used and some of these things need to be restructured to keep that from happening, we need to start looking at that too, because that's driving the Federal deficit in ways like every other part of the Nation's budget is driving the Federal deficit.

So I guess I'm not being difficult with you short term, but what I'm looking for is some kind of assurance that your department—I assume it would be your department's responsibility to start taking a look at this law and come back at some point with some affirmative rewrite.

And not just say 10 years from now, or 20 years from now, or 25 years from now, well, we've got this law and it's benign, and it's not harmful so let's not tinker with it.

Are you doing anything preliminarily to start focusing on what needs to be done to update this law to bring it into current day situation?

Mr. GOTBAUM. Let me be responsive because I don't want to mislead the subcommittee. I don't know what we are doing, but we will. The message is very clear since my job in the Department of Defense is frankly helping them to restructure, and that was the basis on which they got me to take a pay cut to do it.

I just want to be very clear with you that—and this may get me in hot water with folks on this side of the river—I don't think there is a Federal agency which has restructured more than the Department of Defense has in the last 10 years. And this is not just this Administration.

In the last 10 years a number of people in the Armed Forces have been cut by a third to 40 percent, depending on how you count. Our total budget, in real terms, is down by over 40 percent. Our procurement budget, the modernization account, is down by more than two-thirds.

And so, you know, if I were the Chief of Staff of the Army, I would tell you about how I have restructured the way the Army does its business. If I were the CNO, I would tell you about the complete restructuring of the Navy.

I guess I do not want the fact that we have not proposed language to rewrite this law to give you any misimpression that we are not enormously responsive to the fact that the world changed

because, Congressmen, I will tell you, we are and we do it every day.

Mr. WATT. And I don't want to diminish what you've said. I'm sure there has been major restructuring going on. But I can't resist the temptation to say that there's probably not an area in government where circumstances have changed as much as they have in terms of our strategic and military defense also.

There is nobody who can rationally argue that we are, to the degree we were in 1970, or even in 1980 thought we were at risk, that we can now argue that we are at risk. And so while that restructuring has taken place, and is taking place, there is a reason for it.

And we shouldn't just kind of rest in the middle of the process and say, well, we've done more than some other agency, therefore we can afford to drag our feet on this particular issue. I do think it's important for your department to start looking at what makes sense in this law for current day purposes.

Mr. GOTBAUM. I think the Members of the subcommittee have made that pretty clear. And, Mr. Chairman, we are listening.

Chairman CASTLE. With the indulgence of Mr. Watt and the subcommittee, just as sort of a follow up to that, I don't know this but it seems to me that part of the authority which you say are needed is probably needed in time—for instance, we have an article from the *Wall Street Journal* here about the use of it and the need of it during the Persian Gulf War.

So when you get into a wartime situation, this authority which we grant in this legislation is needed more than it is in a peacetime situation, even though you use parts of it in a peacetime situation.

First of all, is that correct? And if it is, it would probably be helpful to all of us if we understood it all better too as part of this further explanation of what this Defense Production Act is.

Mr. GOTBAUM. One of the things that I have learned, Mr. Chairman, since coming to the Department of Defense is that peace isn't all that it's cracked up to be.

I mean, we are at peace now, right? But even so we have folks who are risking their lives in Bosnia. We have had folks who have risked their lives and lost their lives in Somalia. I mention that because one of the things that is quite clear, as you think about what it takes to safeguard the Nation's defense now, is it is all of these things that provide needs.

It is for the Bosnia effort that my staff worked with the Air Force and the Army, and so forth, to procure radios for the folks in Bosnia right now. And so, again, you make the point there is a difference between times of—

Chairman CASTLE. But it goes up and down. You think that's a conflict regardless of how you describe what peace or war is. I understand that there is variations of that.

Mr. GOTBAUM. It absolutely does go up and down. During Desert Storm they processed some 600 of these. Within the last year, I think it's under 100, is that right?

[Pause.]

Sorry, in the last year it was 12. So fundamentally you're right. But, again, I would not want the law to end up being such that we

couldn't get those radios for the folks in Bosnia, for our troops in Bosnia.

Chairman CASTLE. I understand. Mr. Chrysler.

Mr. CHRYSLER. No.

Chairman CASTLE. Mr. LoBiondo.

Mr. LOBIONDO. No.

Chairman CASTLE. Mr. Ney.

Mr. NEY. No.

Chairman CASTLE. Does anyone here in the panel wish to ask any further questions of Mr. Gotbaum?

[No response.]

If not, Mr. Gotbaum, thank you very much. As you may have heard, I think it's important that we understand where we are. We are going to proceed to legislation which essentially reauthorizes this legislation for some time.

I'm not sure if there is any objection to that here. But I think there are some legitimate questions raised about this act in terms of 1995, perhaps in terms of peacetime versus wartime, or however we want to describe it.

And I think it would be helpful perhaps if somebody would go to work on that. We may even want to have a hearing at some point in the future and sort of discuss where it should go next, as a matter of interest.

Mr. GOTBAUM. It sounds to me, Mr. Chairman, like the subcommittee could—this message is received. It would probably be useful in whatever you enact in the report to point out the fact that your view is, yes, it's important to do this but it's also important to pay attention to something. Therefore, the executive branch ought to respond as an entity. Because right now a number of agencies implement these authorities.

And it sounds to me like it would be, in order to be really responsive to your concerns, like not just for the Department of Defense but we all ought to come back to you and say, if you restructure the law, this is how it ought to look. So maybe I'd suggest, sir, that a little helpful advisory in the report might provide some attention.

Chairman CASTLE. Thank you. And thank you very much, Mr. Gotbaum. We appreciate your attendance here today.

[Whereupon, at 11:50 a.m., the hearing was adjourned.]

A P P E N D I X

September 7, 1995

House Committee on Banking and Financial Services

Subcommittee on Domestic and International Monetary policy

Hearings and Mark-up on Export-Import Bank, Tied Aid War Chest Reauthorization and Defense Production Act Reauthorization.

Kenneth Brody, President and Chairman, Export-Import Bank

Joshua Gotbaum, Assistant Secretary of Defense for Economic Security

Room 2128 Rayburn House Office Building

Chairman Michael N. Castle's Opening Remarks:

The Subcommittee will come to order.

Today, the Subcommittee is going to attempt a double hearing and mark-up, off the high board, with a degree of difficulty of 6.5. — We will be hearing from two distinguished witnesses, Kenneth Brody, President and Chairman of the Export-Import Bank - speaking on behalf of reauthorizing the Tied Aid War Chest, and Joshua Gotbaum, Assistant Secretary of Defense for Economic Security - speaking in favor of reauthorizing the Defense Production Act.

Today we will have five minute opening statements by the members present who wish to get on the record. As always, any prepared remarks presented will be accepted for the record. Following the testimony of the two witnesses and the respective questions addressed to each by the members present, we will briefly adjourn if a quorum is not present and then move directly to the respective mark-up of H.R.2203 and H.R.2204. Both of these bills have been introduced by request of the Administration and both extend proven programs that would otherwise lapse.

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OPENING STATEMENT
Rep. Carolyn B. Maloney
Hearing and Markup, DPA and Ex-Im Bank
Subcommittee on Domestic and International Monetary Policy
September 7, 1995

Thank you, Mr. Chairman.

I look forward to the testimony of the panelists on the two important extensions and the new demonstration project we are considering today.

Tied aid credit through the Ex-Im Bank is important to American business. When a foreign government arranges concessional loans or grants for the purpose of winning export contracts for its businesses, our businesses are denied the level playing-field they deserve.

U.S.-led negotiations have chipped away at this practice over the years. But in cases where tied aid credits are still used by a competitor seeking an unfair advantage, it is imperative we have a tool to discourage and, if necessary, to match them. Tied aid credit is that tool, and I look forward to hearing how well the program is working.

The Ex-Im Bank is also seeking authority for a demonstration project. The Bank wants to develop its own performance-pay and promotion system, outside the "GS" system.

Finally, I look forward to testimony on the Defense Production Act, which has been used in every major overseas military conflict since its enactment in 1950.

It is important the President is empowered to require that contracts necessary for critical national defense and security needs take priority over other existing orders.

It is also important the President can use incentives to establish, maintain, or expand production capacity necessary to support the ongoing national security strategy of the United States.

Thank you, Mr. Chairman.

STATEMENT OF
KENNETH D. BRODY
PRESIDENT AND CHAIRMAN
EXPORT-IMPORT BANK OF THE UNITED STATES
BEFORE THE
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY
COMMITTEE ON BANKING AND FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

September 7, 1995

Mr. Chairman, members of the Committee:

I appreciate the opportunity to appear before you to discuss H.R.2203, legislation to extend the Export-Import Bank of the United States (Ex-Im Bank) tied aid credit authority and provide authority for a demonstration project for human resource management.

Ex-Im Bank is requesting a two-year extension in our tied aid credit authority to coincide with the renewal of the Ex-Im Bank charter in Fiscal Year (FY) 1997. Tied aid matching authority has provided Ex-Im Bank with the ability to respond to U.S. exporters financing needs in certain key developing markets. Ex-Im Bank works with U.S. exporters to combat competitive disadvantages caused by our foreign competitors' trade-distorting practice of providing concessional financing to secure export contracts.

The Demonstration Project authority will provide Ex-Im Bank with the means to handle the human resource challenges that this institution faces in an era of dwindling budgets and exploding U.S. exporter demands. It will allow us to follow the examples set by forward thinking companies in the private sector, without additional cost to the taxpayers.

First, let me say that I believe U.S. tied aid policy is producing positive results. We have been able to discourage the general use of tied aid credits in certain types of situations; and on certain projects, we have discouraged our competitors from providing tied aid credits; and on others, we have precluded our foreign competitors from concluding deals. I will elaborate more on these points later in my statement. But, none of these outcomes will be sustained unless the authority to use the Tied Aid Capital Projects Fund is renewed. For without tied aid credit authority, Ex-Im Bank will not be able to provide competitive financing for U.S. exporters in these types of situations.

Tied Aid

"Tied aid" is below-market rate, concessional financing offered by developed country governments (such as France or Germany, the two largest donors) to developing countries. This financing must be used to purchase capital goods manufactured in the country offering the financing. Tied aid financing is underwritten by other governments' aid agencies, and is considerably more attractive to borrowers than the financing typically offered by Ex-Im Bank, and by our counterparts in other developed countries. While these developed country aid agencies claim their primary motivation is the development of the recipient countries, one effect of such cheap financing is that French or German exporters are granted a trade-distorting competitive edge in major emerging markets, where they are able to secure opportunities for follow-on sales and lasting market penetration. Shielded from competitors that are not providing the same cheap money, French or German exporters, for example, are

able to overcome deficiencies in price, quality, or technology, and seize market share in rapidly expanding markets with substantial opportunities for follow-on sales.

Over the years, our competitors' use of tied aid to win key, market-opening export contacts in important developing countries, has posed a serious competitive disadvantage for U.S. exporters, unable to offer matching finance terms. Historically, the U.S. has sought to negotiate reductions in the use of tied aid, rather than match the financing activities of our competitors case-by-case. In fact, the Warchest was originally authorized as a tool for Treasury and the Ex-Im Bank to hasten multilateral negotiations in the Organization for Economic Cooperation and Development (OECD) to eliminate or reduce this practice. These negotiations produced a system for advance notification of tied aid credits, as well as a system whereby any government could request any other governments to accept "no-aid common lines", that is, agreement that particular projects should not receive aid terms. These negotiations ultimately resulted in the February 1992 Helsinki Accord. This Accord placed several key emerging or transitional markets off-limits for tied aid, including Mexico, Brazil, Argentina, South Korea, Poland, South Africa, and Saudi Arabia. Furthermore, the Accord prohibited the use of tied aid for projects which are "commercially viable", according to OECD definition. This designation includes most industrial, power and telecommunications projects. As a result, foreign tied aid use has been reduced by about 50%.

There still remains about \$8 billion per year in foreign tied aid credit offers. These offers include projects in the transportation infrastructure and environmental projects areas,

such as airports, air traffic control, metro systems, ports and navigation, rural communications, and geothermal power plants. These projects are extremely attractive to U.S. exporters and their overseas competitors in representing important market opening opportunities and follow-on sales. By winning sales contracts, firms secure market footholds for future sales expansion.

In the past, the U.S. was only able to counter foreign competition when there was a violation of an OECD requirement. Because there are still a number of offers permitted by the Helsinki Accord, the Tied Aid Capital Projects Fund (the Fund) was established by President Clinton in late 1993 in conjunction with a more aggressive tied aid policy, under the TPCC's "National Export Strategy". The Fund is to be used for matching or countering foreign tied aid credit offers, but not for initiating tied aid credits into export competitions. Ex-Im Bank administers the Fund and carefully considers the merits of each U.S. exporter's request for tied aid credit matching.

Under this new policy, Ex-Im Bank still matches violations of the OECD rules -- which are few and far between because of the Accord -- but our primary focus is to preclude or counter foreign tied aid credit offers that are still permitted. This is accomplished by seeking "no aid common lines", and by issuing early offers of our willingness to match tied aid credits, before specific notifications are filed with the OECD. By precluding and countering tied aid credit offers, we are engaged in an effort to frustrate the efforts of our foreign competitors to use subsidized financing to close off markets for U.S. exports in developing

countries. Thus, the Fund is a vital market-opening tool. While it is not realistic to believe that other governments will eliminate this practice, we do have indications that our countering activities have caused frustration within some foreign governments. We believe that such frustrations have translated into a greater reluctance by our competitors to initiate tied aid credits for projects where U.S. firms have demonstrated a commercial interest.

Since January of 1994, we have offered to match actual foreign tied aid credit offers in 33 cases, involving almost \$2 billion of potential export sales in Indonesia, China, the Philippines, Turkey and Morocco. Thirty-one of these offers are in the Big Emerging Markets, and 28 involve Asia, where foreign tied aid credits are concentrated. Twenty of these offers involve U.S. small business exporters as the lead applicant for Ex-Im Bank's support. While some of these actions were aimed at matching firm foreign tied aid offers, a number of our actions were designed to preclude foreign tied aid offers at an early date, before they became firm, by signalling a U.S. willingness to match. I should emphasize that in each case we reviewed the circumstances of the competition, to ensure that we were not offering to support one-shot or long-shot sales, but rather that we were targeting our support to critical sales by competitive U.S. firms with significant follow-on sales and market penetration possibilities. I would like to point out that tied aid cases in general are prolonged in nature, and involve repeated rounds of bidding and parallel negotiations between buyers and their would-be suppliers, sometimes extending over a period of several years.

In three instances, Ex-Im Bank is countering infringements of international tied aid rules, where: a foreign government ignored an OECD ruling that aid should not be offered; a foreign government breached an agreement not to offer aid for a specific project; and where a tied aid offer was first reported as untied.

In three cases to date, U.S. exporters have won contracts. In only one case so far has it been necessary for Ex-Im Bank to draw on the Fund. This involved a \$7 million financing to support the U.S. export sale of barges to Indonesia by a small business in Maryland, Ellicott Machine Corporation. Ex-Im Bank's tied aid financing enabled the company to displace a Norwegian competitor enjoying tied aid support and regain a foothold in a market where in recent years they had been frustrated by foreign tied aid credits. In the other two cases, the foreign governments decided to withdraw the proposed tied aid credit offers, due in part to U.S. matching, and the U.S. exporters were able to win their contracts using standard Ex-Im Bank financing terms.

In two other cases where contracts remain undecided, foreign governments have withdrawn their proposed tied aid credit offers after Ex-Im Bank offered to match. Therefore, if and when contracts are signed, they will go forward without tied aid credit financing.

Foreign exporters have won contracts financed by committed tied aid in two cases, where Ex-Im Bank matched foreign tied aid credit offers. In three other cases, contracts were

won by foreign exporters, but foreign tied aid has not been committed as yet, and may not be committed.

Twenty-three tied aid credit matching offers remain on the table for undecided competitions. These involve projects that buyers have sought to rebid or renegotiate at a relatively late stage in negotiations. This is done in order to squeeze out the best deal from competing suppliers because of U.S. matching financing. These also include projects where, at an early stage of consideration, Ex-Im Bank's willingness to match foreign tied aid credit offers may lead foreign governments to reconsider tied aid credit offers.

In some of these undecided cases, U.S. exporters can be expected to win contracts. In others, U.S. exporters may well lose, but not for the lack of matching U.S. financing. Where foreign exporters ultimately win contracts, the award may have been delayed beyond their original expectations in the process of competing with U.S. exporters that have been able to match their foreign government's tied aid credit financing offers.

In addition to these 33 cases, since April 1994, tied aid credit matching offers were not needed in another eight cases. In these cases, our "no aid common line" requests for foreign projects were accepted by other governments, thus precluding potential future tied aid credit use. These included a vehicle manufacturing plant, an automatic banking system, airport landing radar systems, a geothermal power project, an overflight terrain survey, a steel plate mill, railway locomotives and a hydropower plant. Since we achieved "no aid" common lines

in these cases, we did not need to provide any preemptive matching indications. Of course, if we receive information that other governments are planning to break these or future "no aid" common lines, we will then support our U.S. exporters accordingly. However, such common lines are only rarely breached.

Thus, we are seeing results from this new aggressive matching policy. Our hope is that our preclusive counteroffers in other cases will lead others to forego consideration of tied aid offers. However, if other governments persist in going forward with the tied aid credit offers, we stand ready to support our exporters.

The number of tied aid offers provided by foreign governments are still significant at \$8 billion. According to OECD 1994 notification statistics, about \$6 billion of this total involved grant elements in the range of 35%-50%, the kind we find most trade-distorting. This \$6 billion is generally targeted by our competitors at medium-income, fast-growth countries, including "Big Emerging Markets" which remain eligible for tied aid. This is the kind of tied aid we are countering. The remaining \$2 billion in high grant-element tied aid was mostly for lower-income, lower-growth countries, which are extremely dependent on foreign aid. Of the \$6 billion in low grant-element tied aid offers, about \$3 billion in offers was extended to just two "Big Emerging Markets", China and Indonesia. The remaining \$3 billion of low grant-element tied aid offers was distributed among a large number of developing countries, including countries such as the Philippines, Turkey, Tunisia, Pakistan, Morocco, India, and Peru.

The two largest tied aid markets, China and Indonesia, attract the majority of these offers. Both of these dynamically growing economies actively solicit tied aid packages from France and Germany, two of the largest tied aid providers. And since China and Indonesia are the principal recipients of our competitors' tied aid, it follows that these are the markets where we do the bulk of our tied aid matching. The Chinese and particularly the Indonesian central authorities would prefer that Ex-Im Bank not match others' tied aid credits, but rather provide large direct tied aid lines-of-credit, which the planner could then allocate among projects on a non-competitive basis. The French would get theirs, the Germans theirs, and the Americans theirs. However, Americans seeking to compete for projects receiving French or German tied aid credit would still be out of luck. While a few U.S. companies with influence on the central authorities would win contracts on the basis of such non-competitive lines of credit, we would be abandoning those less influential exporters who are trying to win competitive deals against foreign tied aid out in the field.

We have explained to the Chinese and Indonesian central authorities the economic advantages of receiving matching tied aid offers, in that they can truly compare projects on the basis of price, technology, quality, delivery and service. The purchasing ministries, who are more familiar with projects, already understand that tied aid is often used as a substitute for high prices or poor quality, and welcome a leveling of the financial playing field. We are willing to work with either the central authorities or the purchasing ministries to ensure that U.S. suppliers, with Ex-Im Bank matching offers, are truly considered.

Congress has fortunately recognized the importance of the tied aid credit market reality — today's early matching actions can potentially lead to significant financing commitments in future years — by permitting tied aid carryover authority from year to year. At this point, we have \$264.4 million in budget authority for leveraging our tied aid matching operations. This includes \$93 million from FY'95 tied aid appropriations that we can carry over into future fiscal years. When we match others' low-grant-element tied aid, our subsidy percentages are between 25% and 40%. The current authority could cover Ex-Im Bank tied aid credit budget calls for actual financing of between \$600 and \$900 million of signed U.S. export contracts requiring concrete tied aid credit financing. We need these carryover funds to maintain a credible commitment in the eyes of our foreign competitors. This is the only way the Fund can act as a deterrent.

But, Administration and Ex-Im Bank policies and programs are only as good as the people who carry them out. This leads me to Ex-Im Bank's request for Demonstration Project authority for the Bank.

Ex-Im Bank Demonstration Project

The core and effectiveness of any institution is its personnel. To most effectively and efficiently handle Ex-Im Bank's limited human resources, during a period of dwindling budgets and ever increasing U.S. exporters' demands in expanding markets, the Bank is requesting authority to undertake a Demonstration Project. This project will emulate the best the private sector has to offer, within the constraints of our current administrative budget.

Since 1993, Ex-Im Bank has undergone an extensive restructuring, aimed at "making a difference" (assuring that each export financed would not go forward without the Bank's support), improving customer service and giving the U.S. taxpayer more value for the dollar spent. These goals, however, have not been accomplished without instituting a new personnel management system, whereby evaluations would be accurate, qualified employees recruited, and hard-working employees rewarded.

But, more changes are necessary if the Bank is to achieve the highest rank in customer service and give the most value to the U.S. taxpayer. Over the last two years, the Bank has been processing more cases. However, as the volume and complexity of the transactions have increased, personnel numbers have not. In fact, they are decreasing. Ex-Im Bank's current FY'95 full-time equivalent level is 448 positions with a level of 438 positions expected by the end of FY'96. Consequently, to meet these challenges, Bank managers must have the flexibility in hiring, greater leeway in human resource development, career mobility, and the ability to reward deserving employees using both salaries and promotions. The present General Schedule (GS) system is inadequate to accomplish this task. It allows different employees with greatly varying performance to work side-by-side in the same grade, regardless of merit, and values seniority more than accomplishment. Thus, promotion and reward for outstanding accomplishments are difficult because employees are rigidly classified in narrow grades, which results in not enough incentive to excel.

As a Government corporation, Ex-Im Bank is not covered under OPM's Demonstration Project authority. If Congress grants the authority to utilize a Demonstration Project, Ex-Im Bank would work with OPM to develop its own classification, pay-for-performance and compensation systems apart from currently established government-wide systems. This is nothing new or different, since other government agencies already have this ability. The project, which, as I have said, would be revenue neutral, would give the Bank authority to compete with other employers within and without the government to hire high-quality employees. One concept we want to explore is "broadbanding", so that the current constricted job classification system would be replaced by wider classifications to allow for more flexible pay. Adjustments would be unhampered by these same outmoded classifications and rewards would be directly linked to the quality of work. The project would be accomplished within the current request for our administrative budget and would not cost the taxpayers any extra money.

This project is being conducted jointly by Ex-Im Bank and the Office of Personnel Management. The project has a lifespan of five years, but may be extended by law. No more than 5,000 employees may participate per project. During this five-year period, the project must undergo on-going evaluations. Under the Demonstration Project authority, all laws and regulations under Title 5 of the U.S. Code may be waived except those dealing with leave, benefits, political activity, merit principles and equal employment opportunity.

Conclusion

Over the past several years, Ex-Im Bank has been at the forefront in the international global marketplace, whether in standard financing, project financing, or tied aid. Our aggressive policy and program changes have made a difference and are continuing to make a difference to U.S. exporters. We are supporting more exports.

But, although we are winning the export battle, the war is not over. Ex-Im Bank needs a renewal of tied aid authority to continue to combat the egregious financing practices of our foreign competitors. This tool plays a critical role in our trade arsenal for market-opening. The Fund is used to reduce the incentives for our competitors to initiate export subsidies, and to protect U.S. exporters should our competitors go ahead and offer such subsidies. While we have been able to obtain some definite results from our more aggressive tied aid policy, the problem still exists. At a time when our trade deficits are continuing to escalate, exports are more important than ever. We cannot unilaterally disarm, because U.S. exports mean higher-paying jobs and a better standard of living for U.S. workers.

At the same time, to handle the increasing demands being placed upon this world class institution, Ex-Im Bank needs to optimize its human resource management. The Demonstration Project will provide the institution with the means to maintain the institution's goals of making a difference, improving customer service and giving the U.S. taxpayer the most value for the dollar spent.

Again, I appreciate the opportunity to present Ex-Im Bank's legislative request and I will be happy to answer any questions you might have at this time.

Statement of
Joshua Gotbaum
Assistant Secretary of Defense for
Economic Security
on the
Defense Production Act

before the
Subcommittee on Domestic and International Monetary Policy
House Committee on Banking and Financial Services
September 7, 1995

Good morning. Mr. Chairman and members of the committee, I appreciate the opportunity to share with you the Department's views regarding the Defense Production Act and the role it plays in helping to obtain the goods and services needed by our military forces during both conflict and peacetime. I want to also express the Administration's support for H.R. 2204 which will reauthorize the Act through September 30, 1998.

My testimony will include a brief history of the Act, a discussion of the authorities it contains, and how the Department uses these authorities to support our Armed Forces. In addition, I will briefly discuss how the Department is planning to use the authorities contained in the DPA to implement an effective dual use program. I will complete my formal testimony with a statement of support for H.R. 2204 and the need for a timely reauthorization of the DPA.

Let me start by saying a few words on why the DPA is important to the Department of Defense. It has long been the policy of the United States to have an industrial and technology base capable of meeting national defense requirements, and to maintain technological superiority on the battlefield. The DPA affirms this policy but more importantly it contains the authorities to make this policy a reality. These authorities are unique and provide the Department the ability to maintain a strong domestic industrial base that will be responsive to threats to the national security of the United States. The authorities contained in the DPA allow the President to:

1. direct priority performance of defense contracts and allocate scarce materials, services, and industrial facilities to ensure the security of the Nation; and,
2. establish, expand or maintain essential domestic industrial capacity.

History of the DPA

The DPA was established in 1950 to mobilize the nation's production capacity in response to the material shortages experienced during World War II and the outbreak of the Korean War. Of the seven original titles, only three remain: Title I - Priorities and Allocations; Title III - Expansion of Productive Capacity and Supply; and Title VII - General Provisions. The Act has been reauthorized several times since 1950; most recently in 1992. The President delegated the authorities contained in the DPA through Executive Order 12919, dated June 7, 1994. Unless renewed, the Act will expire on September 30, 1995.

Title I - Priorities and Allocations

Since the enactment of the DPA, the authorities contained in Title I have been used to provide our Armed Forces with the materials they need to meet any threat to national security. Title I authorizes the President to:

1. require priority performance on contracts and orders, as necessary, to meet approved national defense and emergency preparedness program requirements; and,
2. allocate the Nation's materials, services, and facilities as necessary to promote national defense.

Executive Order 12919 delegated the authorities contained in Title I to the Federal Departments and Agencies. To implement these authorities the Department of Commerce administers the Defense Priorities and Allocations System (DPAS). The Defense Priorities and Allocation System: (1) establishes priority ratings for contracts; (2) defines industry's responsibilities; and (3) institutes enforcement procedures.

The Department of Defense has been delegated the authority to apply priority ratings to contracts and orders. A priority rating is placed on approved defense contracts. In essence, the DPAS serves as an insurance policy in the event of conflict or contingency.

While the Priorities and Allocations authorities contained in Title I have been used extensively and have proven invaluable since 1950, recent history, including Desert Shield/Storm and now Bosnia, illustrates their continued importance. The authorities contained in Title I proved invaluable during Desert Shield/Storm and ensured that industry provided priority production and shipment of essential items urgently needed by the coalition forces. Close to 600 cases were handled during the conflict. Notable examples included:

Global Positioning System Receivers: When demand for these receivers outstripped the capacity of suppliers, the Priority and Allocation authorities were used to expedite shipments and to allocate available systems to units in the coalition force that had the most urgent requirement.

Activated Charcoal for Gas Masks: When the demand for activated charcoal for gas filter masks outstripped the production capacity of Calgon Corporation (the sole producer of activated charcoal for gas masks), Priority and Allocation authorities were used to direct Calgon to ship all charcoal produced to meet military requirements.

Search and Rescue Radios: Motorola, the producer of these radios, had closed their production line and anticipated it would take several months to restart production with vendor supply of component parts being the pacing item. The Priority and Allocation authorities enabled the Commerce Department to work with Motorola's supplier base and reduced the time to restart production of the radios by more than half.

Title I is a powerful tool that is used judiciously to ensure that our Armed Forces and those of our allies can obtain the materials they need to meet any contingency that threatens the national security. In a most recent example, Title I authorities are being used to assist the British obtain a man-portable radio, urgently needed by the their forces in Bosnia.

The Fiscal Year 1995 Defense Authorization Act redefined "national defense" and amended the DPA to allow the authorities contained in Title I to be used in the event of a national disaster. Now, for the first time, the Priorities and Allocations system that helped the military respond to threats to national security can also be used to help victims of hurricanes and earthquakes.

On occasion, when the DPA has lapsed, similar authorities provided in Section 468 of the Military Selective Service Act (SSA) of 1948 have been used as a substitute to establish priority for essential defense equipment. However, the authorities in the SSA have some serious limitations. They do not apply to service type contracts (e.g., no priority to obtain commercial berths for container ships during a national emergency). They limit priority contracts and orders to equipment for the exclusive use of U S military forces (no provision for support of other U S. defense needs or of friendly foreign armed forces (not an issue during Operation Desert Storm since coalition forces were under operational control of U.S. commanders)). Also, the SSA does not apply to transportation services which are critical to national defense. Finally, the

SSA does not protect contractors priority to defense orders. Because of these shortcomings, the SSA is inadequate for setting and managing defense priorities within the industrial base, and the DPA is a much preferred vehicle for this purpose.

Title III - Expansion of Productive Capacity and Supply

Title III authorizes actions to establish, expand or maintain essential industrial capacity needed for national defense. Title III addresses these shortfalls by offering financial incentives to industry which reduce the risk of establishing the needed capacity. Financial incentives authorized in the DPA and used by the Department include: purchases of industrial resources or critical technology items for government use or stockpiling; purchase commitments which allow the government to guarantee a market for an industrial resource or critical technology item; and purchase of production equipment which can be installed in government or commercially owned facilities.

Projects are identified and funding decisions are made based on national security considerations and a demanding project identification and selection process is in place to ensure that only those industrial resource or technology shortfalls essential to national defense are addressed by the Title III Program. The military services play an active role in this process. In addition, Congressional control and oversight of Title III Program is maintained through the requirement to identify in the defense budget or in a budget amendment the industrial base shortfall being corrected. This budget submittal has to be accompanied by a determination that the project meets the following criteria:

- the industrial resource or critical technology item being corrected is essential to national defense;
- United States industry cannot reasonably be expected to provide needed capacity in a timely manner on their own;
- Title III is the most cost effective and expedient method of addressing the shortfall; and
- the combination of defense and foreseeable nondefense demand for the industrial resource or critical technology item is more than the domestic output will be at the conclusion of the Title III project.

The law requires that we wait 60 days after Congressional notification before any action is taken to address an industrial base shortfall. Title III contracts are awarded competitively. Increased levels of cost sharing by the contractor are now required which increases their commitment and the likelihood that the project will result in a viable production facility capable of supporting defense requirement in the future.

During the Korean War era, the Title III Program was very active and was responsible for the creation or expansion of about 60 materials, including creation of the titanium industry and expansion of the machine tool and aluminum industries. After a long hiatus, the DoD requested and Congress appropriated funds for the Title III Program in 1985. The reactivation of the Program was in response to the defense build-up under President Reagan and the concern by the Administration that we were becoming increasingly dependent on foreign sources for materials essential for the nations defense. Since 1985, the Title III Program has been instrumental in establishing domestic production capability for key materials and components used in the Nation's weapons systems. This includes high purity quartz yarn used in advanced polymer matrix composites in such applications as missiles, rocket motors, thermal protection, and stealth aircraft; traveling wave tubes used to increase the survivability of fighter and attack aircraft; high modulus, pitch-based graphite fiber used in missile, aircraft, and satellite applications; and, Accelerated Cooled/Direct Quenched (AC/DQ) steel for ships that reduces the need for strategic and critical alloys while offering superior strength. Phase I of this project successfully demonstrated that AC/DQ steel could meet the Navy's steel plate requirements but the project did not proceed into Phase II because of a decline in the Navy's shipbuilding program. Today, there are seven active Title III projects valued at over \$140 million dollars and plans are underway to initiate two new projects in metal matrix composites. Active projects include:

High Purity Float Zone (HPFZ) Silicon: This project, valued at \$12.0 million, is establishing a low cost capability to produce HPFZ silicon. HPFZ silicon is essential in manufacturing infrared and laser seeker detectors and high power switching devices. Prior to this project no domestic source existed. A contract award was made in November 1993 to Unisil Corporation in Mountain View, California. Since this award, the contractor has established an initial production capability and demonstrated the ability to efficiently produce HPFZ silicon.

Semi-Insulating Gallium Arsenide (SI GaAs) Wafers: This project is valued at \$31.5 million and is helping to retain a viable domestic capability to produce SI GaAs wafers in support of military and commercial requirements. SI GaAs wafers are used in radar, electronic warfare, and communications systems. Three

contracts were awarded under this project in March 1994. All three contractors have made exceptional progress in increasing production capabilities and increasing sales.

Open Architecture Machine Tool Controllers: This project, valued at \$7.9 million, was awarded to a U.S. consortium in March 1995. The project is developing, building, and testing an open architecture controller. This controller will allow users to customize controller systems to achieve optimal solutions to specific applications. A healthy machine tool industry is vital to the nation's defense and this project is attempting to revitalize the controller industry a key component of this industry. In addition, an open architecture controller will facilitate flexible manufacturing and aid in the integration of the commercial and defense industries and optimize small lot production of defense requirements.

Active Matrix Liquid Crystal Cockpit Displays: This \$20 million project is facilitating the insertion of flat panel displays into military systems through qualification and accelerated purchases of displays. Insertion of these displays into seven weapon systems, including the Army's Apache Helicopter and the Navy's F/A-18 Aircraft, will enhance their performance and reduce the cost of ownership of these systems.

High Resolution Imaging Flat Panel Display Systems: This project is jointly funded by Title III (\$30 million), the Advanced Research Projects Agency (\$20 million), and industry (\$50 million). Industry participants are Xerox, AT&T Bell Laboratories, and Standish Industries. The objective of the project is to develop manufacturing expertise and a pilot facility to produce ultra-high resolution displays needed for mapping, satellite imaging, target designation, and intelligence applications. The first year of the effort saw substantial progress and achieved significant improvements in manufacturing processes and cycle time.

Silicon-on-Sapphire (SOS) Wafer: This project, valued at \$23 million, is establishing a viable domestic source of supply for SOS wafers which provide a measure of radiation hardening essential for operation of electronic systems in space or in a nuclear environment. The contract is scheduled to be completed in December 1995. The contractor Union Carbide Chemical and Plastics Company, established a viable capacity that, due to Title III, is now competitive on a quality and price basis in the international market.

Discontinuous Reinforced Aluminum (DRA): DRA is significantly lighter, stiffer, more temperature resistant and dimensionally stable than current aluminums. The Title III project, valued at \$25.7 million, is establishing a viable production capability and

reducing the cost of the material. Military applications include: the F-16 ventral fin the C-141 escape hatch, and actuators where DRA is being used as a replacement for titanium. In addition, a significant commercial opportunity is being pursued with Pratt & Whitney for exit vanes in commercial jet engines which will result in a very large market for DRA and further cost reduction to DoD.

The Title III Program is unique. As the above projects demonstrate, Title III allows the Department to bring new technologies from the laboratory to the factory floor. The authorities contained in the Defense Production Act provide the Department with a flexible range of tools that can be used to preserve essential capabilities. There are numerous Department of Defense research and development programs including the Manufacturing Science & Technology Program, that develop manufacturing technology but none have the mandate to allow them to transition that technology into production. In addition, there are no other procurement programs that are focused on identifying and correcting critical material or component shortfalls. The Department's procurement dollars are focused on end item procurements and while an individual weapon systems program office may address a problem unique to its system, it is unlikely that it would attempt to develop a domestic source of supply for a generic component or material for generic items. The Title III Program by working with the military services and industry, identifies critical shortfalls in the domestic industrial base and takes action to correct that shortfall, often in support of multiple weapon systems. Title III also has unique authorities and the ability to restrict competition to domestic sources which are ideally suited to the role it plays in the Department's acquisition process. The mission of the Title III Program is to establish viable domestic industrial capacity, capable of supplying defense requirements long after the Title III project has been completed. There is no other program in the Department that has this mission or has the authorities and resources to effectively accomplish this mission.

Title III's Role in the Department's Dual Use Strategy

The Title III Program is an essential component of the Department's Dual Use technology strategy. Dual use technology policy will result in shortened weapon system development times, reduced life-cycle costs, and increased weapon system performance. The goals of the dual use technology investment strategy are greater integration of the commercial and military industrial sectors and increased use of commercial products in military systems. Given that the bulk of spending for R&D is in the commercial sector, coupled with the decreased defense budgets, both of these goals are not only desirable but inevitable.

Title III's flexibility (range of incentives available), mission of moving technology from the laboratory to the factory floor, and its emphasis on establishing a viable domestic source make it one of the few programs that can foster dual use technologies while preserving essential defense-unique industrial capabilities.

As part of our efforts to preserve essential industrial capabilities, we are conducting a number of sector assessments in some key areas. These include: conventional ammunition; space launch vehicles; helicopters; torpedoes; tracked vehicles; heavy bombers; and, Meals-Ready-to-Eat. In addition, we have initiated technology studies in electronic packaging, semiconductors, advanced materials, advance computing, and microelectromechanical systems. The Title III program will play an important role in addressing areas of concern identified in these assessments. The two flat panel display projects discussed above are a result of findings from our first assessment - Flat Panel Displays. A second assessment - Advanced Materials - is nearing completion and the two planned projects on metal matrix composites are a result of that assessment.

Title VII

Title VII of the DPA contains general provisions that include:

1. standards and procedures by which voluntary agreements and advisory committees may be developed with representatives from the private sector to help provide for the defense of the United States;
2. authority to establish and train an executive reserve of recognized experts from the private sector that can be called upon in the event of a national emergency; and,
3. Section 721, commonly known as the Exon-Florio Provision, authorizes the President to review certain mergers, acquisitions and takeovers by foreign firms and to prohibit those actions that would threaten or impair national security.

In addition to these provisions, Title VII also contains authorization to appropriate funds for the execution of the Title III Program. Together the authorities contained in Title VII provide the President an important set of tools that can be

used to effectively plan and put in place the mechanisms required to meet any threat to national security.

Reauthorization of the DPA

The Administration supports H.R. 2204 which would reauthorize the DPA through September 30, 1998. The Senate Committee on Banking, Housing, and Urban Affairs adopted a similar Bill - S. 1147 - on June 28, 1995.

The DPA expires on September 30, 1995. In 1990, the last time the DPA came up for renewal, it was allowed to expire. Unfortunately, this occurred during Desert Shield/Storm and Congress passed two short term amendments in 1991 while it considered the multiyear reauthorization which was passed in September 1992. During lapses in coverage of the DPA, the Department had to use the authorities contained in Section 468 of the Military Selective Service Act. As previously discussed, the Selective Service Act contains some serious shortcomings that had to be worked around. The authorities contained in the DPA are important and as past experiences demonstrate needed for national security. I hope this time we can reauthorize the DPA without any lapses in authorities. We stand ready to assist you in this endeavor in any way we can.

We appreciate the opportunity to discuss the DPA with you today and look forward to working with you to ensure a timely reauthorization of the DPA. I will be pleased to answer any questions you may have.

Kenneth D. Brody

Mr. Brody has served as the President and Chairman of the Export-Import Bank of the United States since May of 1993. He has expanded the Bank's impact on trade and export issues in a number of ways serving as Deputy Chair of the Trade Promotion Coordinating Committee (TPCC) and leading the Working Group that developed the National Export Strategy.

Mr. Brody promotes Ex-Im Bank and the interests of U.S. exporters, focusing primarily on emerging markets around the world, and counts as early achievements his re-organization of Ex-Im Bank, including the establishment of a project finance group and a new small business program.

Prior to his confirmation, Mr. Brody was a member of Goldman Sachs investment banking firm from 1971 to 1991. He was elected a general partner in the firm in 1978, and a member of its management committee in 1990. At Goldman Sachs, Mr. Brody was co-head of the merchant banking group, headed the real estate group, and founded and headed the high technology group. Mr. Brody also advised the government of Mexico on the privatization of its telephone system. Mr. Brody has extensive international financing experience and was a founding partner of Petrus Partners, a private investment firm. Prior to joining the Ex-Im Bank, Mr. Brody was in a leadership position in many charitable organizations, including the American Federation for Aging Research and the Alvin Ailey Dance Company.

Mr. Brody holds an MBA from the Harvard Business School, and an undergraduate degree from the University of Maryland. President Clinton has also appointed Mr. Brody to the Board of Governors of the American Red Cross.

Joshua Gotbaum

Mr. Gotbaum serves as the Assistant Secretary of Defense for Economic Security. This position was created to manage commercial and economic concerns for the Department of Defense's programs and policies. Mr. Gotbaum is the primary advisor to the Secretary, Deputy Secretary and the Under Secretary of Defense for Acquisition and Technology for matters pertaining to the defense industry, dual-use technology, and international cooperative programs. He also directs the Department's efforts concerning infrastructure, including housing, base closure, property disposal and reuse and economic adjustment.

Prior to his confirmation in May 1994, Mr. Gotbaum was general partner with the New York investment bank, Lazard Freres & Co. His work included financial advice and assistance to corporations, trade unions and governments on corporate finance, mergers, acquisitions, divestitures, bankruptcies and restructurings. He was promoted to general partner in 1990. From 1990 to 1992, he was resident in London as managing director of Lazard Freres & Co., Ltd.

Gotbaum served in 1981 as legislative assistant to U.S. Senator Gary Hart for economic and budget matters. During the Carter Administration, he was Associate Director of the White House Domestic Policy Staff for economic issues. In 1978 and 1979, Gotbaum served as Executive Assistant to Alfred Kahn, President Carter's advisor on inflation. In 1977, he worked in the White House Office of Energy, Policy & Planning. When the Department of Energy was established, he joined the office of the Assistant Secretary of Energy for Policy.

Mr. Gotbaum is a graduate of the Kennedy School of Government and Harvard Law School. He received his undergraduate degree from Stanford University.



Federal Emergency Management Agency

Washington, D.C. 20472

SEP 6 1995

The Honorable Michael Castle
 Chairman, Subcommittee on Domestic and
 International Monetary Policy
 Committee on Banking and Financial Services
 United States House of Representatives
 Washington, D.C. 20515

Dear Representative Castle:

We appreciate your sponsorship of H.R. 2204, a bill that would reauthorize the nonpermanent provisions of the Defense Production Act of 1950, as amended (DPA), that will expire on September 30, 1995. Unless the DPA is extended, we will not have the statutory basis for the readiness of the Nation's industrial resources for use not only in wartime, but also in catastrophic disasters.

The need for the DPA is important because Title I of the Act authorizes a priority rating system that can be used in defense procurement to allow faster delivery of essential equipment, fuels and transportation services for our military needs. This authority also is important for response to a large-scale domestic disaster.

Title III of the Act provides the President the authority to establish, expand or maintain industrial capacity essential for national defense.

Title VII authorizes a National Defense Executive Reserve (NDER) program which is comprised of civilian executives that could be utilized by the civil departments and agencies to mobilize resources for defense or catastrophic disaster-related requirements. Non-reauthorization of this provision would result in the loss of talent and experience that Federal departments and agencies may need in a crisis.

We urge Congress to act favorably on H.R. 2204 and appreciate your support in its passage.

The Office of Management and Budget advises, that from the standpoint of the Administration's program, there is no objection to the submission of this letter.

Sincerely,

A handwritten signature in dark ink, reading "Kay C. Goss", is written over the typed name.

Kay C. Goss
 Associate Director
 Preparedness, Plans and Exercises

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